RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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July 27, 1983 **LETTER 866**

July 15, DJIA 1192.31; A-D Ratio –14.13; PTI 1677
July 22, DJIA 1231.17; A-D Ratio –13.62; PTI 1685

THE MARKET: In the last report I said to watch the Transportation Average on any market decline. The Transports, I wrote, were the "strength of the market." This proved out on the decline to the July 18 close. At that point the Dow was down to 1189.90, but the Transports closed at 556.48, a full *18 points above* their May 19 low of 538.07.

Even more impressive was the powerful rallying trend in the D-J Utility Average–this despite rising interest rates (the Utilities are very rate-sensitive) and despite the falling stock market (see chart).

Another most interesting phenomenon of the last few weeks was the down-pointing wedge pattern that formed in the Dow. The descending wedge is a classic corrective formation, a formation that is usually seen during bull markets. A descending wedge implies a situation in which *selling is drying up as the market declines* (diminishing volume should accompany a wedge formation).

On July 20 the following occurred: (1) The Dow broke out above the upper trendline of the wedge, rising over 30 points. (2) The Transports rallied sharply, closing up over 15 points. (3) The really sensational action was the D-J Utility Average roaring to a new 1983 high and its highest level since 1969! (The Utility Average tends to be a bellwether for the general market). (4) All 30 stocks in the Dow rallied on July 20; this hasn't happened since January 5, 1976. (5) NYSE upside volume was ten times downside volume, a very positive indication for the general market. (6) Total NYSE volume swelled to over 100 million shares during the rise.

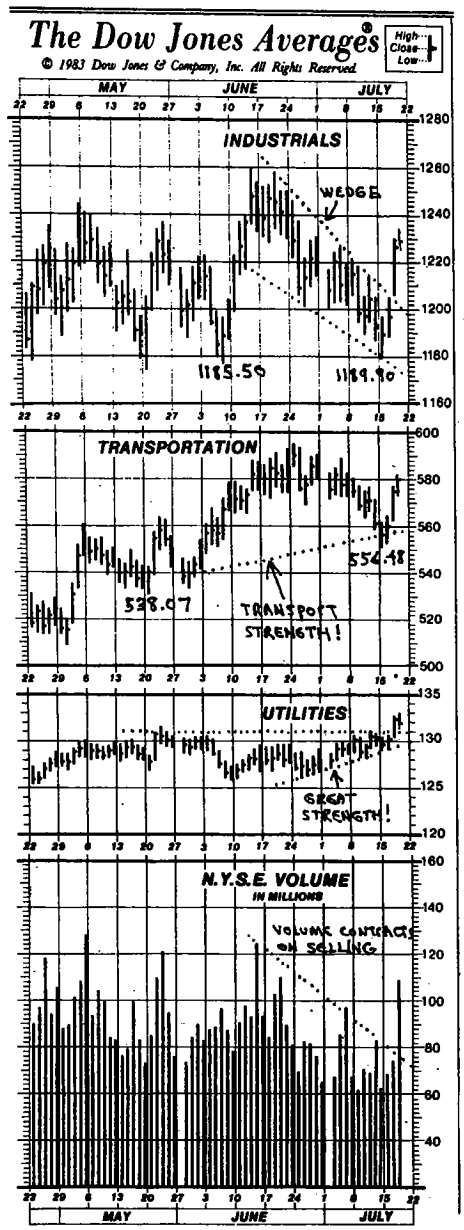
I said in the last Letter that my Primary Trend Index (PTI) was continuing to hold in its bullish up-trend, and that in remaining strong it was diverging (in a positive way) with both the weaker Dow and the A-D ratio. I added that the market would not fall apart as long as the PTI remained in its bullish trend.

On July 18 the PTI declined to within a few points of its rising trendline (see page 2 chart). But July 19 and 20 saw the PTI reverse itself and then rally to within 2 points of its July 6 high of 1687. On July 21 the PTI rallied to exactly its July 6 record high of 1687 (see Late Notes).

As an added item of interest, on July 21 the NYSE announced that the short interest had jumped a whopping 12% to a record 166 million shares sold short. This takes the short-interest ratio to (my estimate) a bullish 1.90. Remember, the most bullish phenomenon possible during a bull market is skepticism regarding the bull trend. A rising short interest is an indication of skepticism, and certainly a record high short interest suggests that many traders believe the easiest money is to be made on the downside. The bull detests this kind of disbelief in the primary trend, and more often than not he punishes the disbelievers-by moving higher!

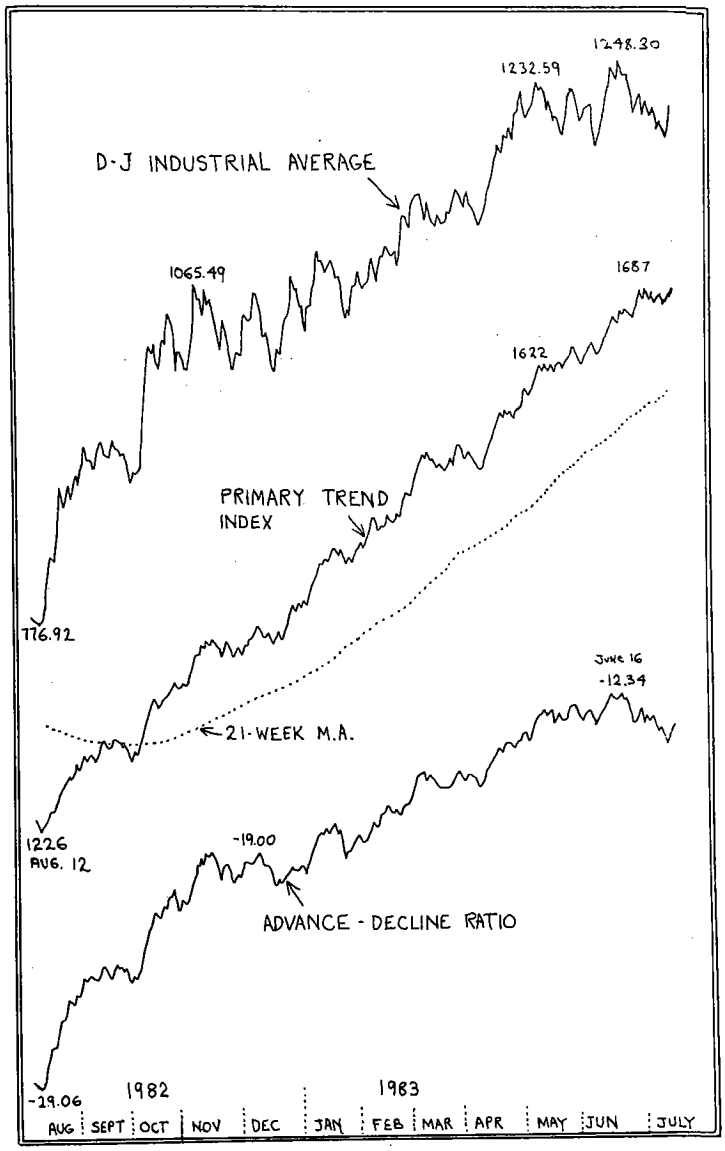
PRIMARY TREND: There is one overriding fact that will guide investors as far as making or losing money is concerned. That fact is so basic, so fundamental, that it is lost on perhaps 85% of all stockholders. What is this mysterious piece of information? It is this: if the primary trend is UP, then in due time, regardless of all reactions, hesitations and consolidations, the market and MOST STOCKS will move higher. It may take a month or a few months or it may take a year, but most stocks will, in due time, hit new highs while the primary trend is bullish (the reverse, of course, is true during a primary bear market).

Some expert traders are able to stay with a primary rise, then skip nimbly out ahead of any secondary reaction. Note that I say nimble traders, because that's exactly what you have to be. But unfortunately, nimbleness in one's market operations isn't easy (unless you are a floor member). And there is always the cost of commissions to consider (both buying and selling commissions).



I've been dealing with stock market action and investing ever since 1945, and I've had a chance to watch a lot of traders and investors at work. The great Dow theorist of the 1930's was Robert Rhea, and Rhea was not only a superb analyst and teacher, he was an outstanding market practitioner. Rhea would trade the market, and as I remember he recorded three profitable trades for every losing trade throughout his career.

But the man who really impresssed me was the Dow Theory genius of the 1940's through the '70's, E. George Schaefer.



Schaefer's philosophy was simple and fundamental. Load up with stocks during a bull market, and buy more during every reaction in the bull market. Schaefer became fully invested in 1949 when the great 1949-66 bull market began. He bought additional stock during all the reactions on the way up, and he finally sold out in 1966. His model accounts ($50,000 in each of 2 accounts) ended up at over $1 million, and that was impressive enough for me. I don't think I know anyone who had a better record than Schaefer during the 1949-66 period, and Schaefer really preached one basic principle: "***Stay with the primary bull trend and add to your stock position during all periods of weakness or reaction***." I saw Schaefer's principle work well all through the big bull market, and that made a deep impression on me. What Schaefer was really saying was, "***Let the primary trend work for you. Harness the power of the market and be patient.***"

Of course there is a problem regarding the "ride it out" strategy. That problem is that one never knows how far a secondary reaction will carry. And no doubt about it, some secondaries can be hairy–they can frighten you to death (as those who lived through 1957 or 1962 know). But in the end, a primary bull trend bails out all mistakes and makes money for almost all patient stockholders.

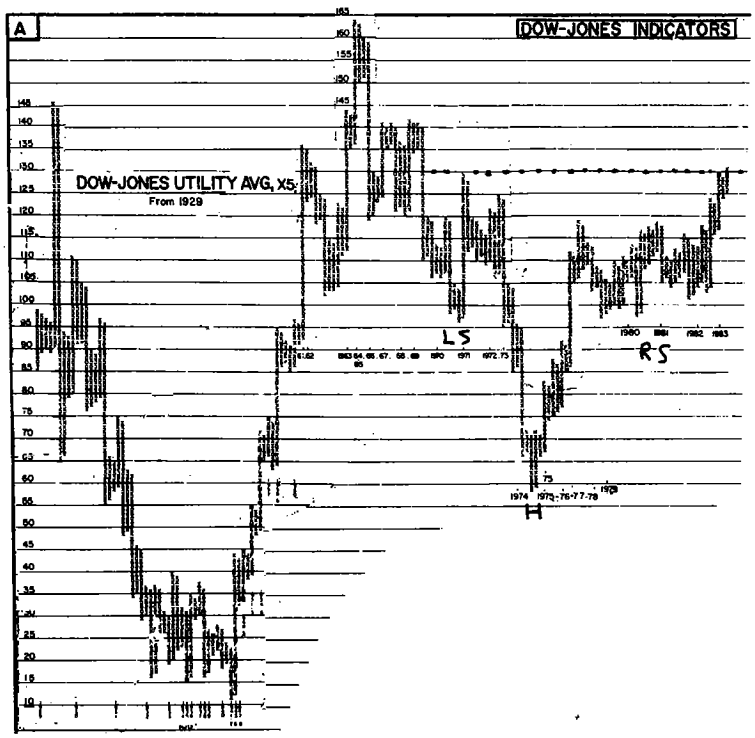
INVESTMENT POSITION: It should come as no shock to readers to learn that I am still bullish on this market (thus, the bull in this box). The action of the Averages is impressive, the PTI is strong and the short interest and margin accounts are at record highs. Our position–we're sitting patiently with no-load (growth) funds plus the full list of the recommended defense stocks. During a primary bull market you have a number of allies, and one of them is TIME. To make use of time, you need PATIENCE. Sit tight with your positions and let time work for you. Remember, the primary trend is the most powerful force in the market–and you've got that trend working for you now.

THE UNKNOWN: I've written many times that what everyone knows about Wall Street ceases to be a market factor. At present, everyone knows that the debts are huge and that interest ultimately has to head for the moon. But wait a moment. There's something that doesn't fit into the "accepted wisdom," and it's something I want to write about here.

This remarkable chart traces the action of the D-J Utility Average from 1929 to date (every rally or decline of 5 points or more is shown). But what interests me is the massive bottom formation which I have labeled on the chart. What the formation looks like is a huge head-and-shoulders bottom with the left shoulder formed around 1971, the head formed during the 1974 smash, and most recently (since 1980) a giant right shoulder.

The resistance line (dotted horizontal line) comes in at about 130. In May the Utility Average pushed temporarily above the 130 level, and since then the Utilities have held amazingly well in the 128 to 130 area (despite rising interest rates and despite a sloppy market).

The Utilities are sensitive to interest rates–very sensitive. So I ask myself, why should this interest sensitive Average be forming a huge head-and-shoulders bottom when everyone knows that interest rates are headed much higher? And my answer is–maybe



something doesn't fit. Maybe the common knowledge about interest rates isn't true. Maybe the Utility Average is telling us that what every one knows about interest rates isn't worth a plug nickel.

The chart is interesting from another standpoint. The Utility Average tends to be a market bellwether. This is true because (1) utility companies are geared closely to national power usage, (2) utility companies use a lot of coal and oil and therefore they are sensitive to inflation, (3) utility companies borrow great quantities of cash, and they are therefore very sensitive to interest rates.

So as I see it, this chart presents a potentially fascinating picture. If the Utility Average breaks out decisively above 130 and heads up, that action would have very bullish implications for the rest of the stock market. The Utility Average is the only stock average that has not pushed to record highs during this bull market. So I'm watching them closely, very closely from here on. As a point of interest, study the Wall Street Journal daily chart of the Utilities. Note that despite rising rates, the Utility Average has done surprisingly well over the last few months. (Chart of the Utility Average courtesy of Market Charts, 20 Exchange Pl., NYC 10005).

DEFENSE: Few, very few people comprehend the enormity of the world defense spending. Roughly 30% of ALL world spending now goes into defense. Roughly 45% of all the stocks on the NYSE are engaged in some form of defense production or high-technology production that is defense connected.

This little item from the June 28 Houston Post will give you some faint idea of how big defense spending can be. Furthermore, a large portion of the TI $7 billion contract will probably sift down to sub-contractors, and all this is worth pondering.

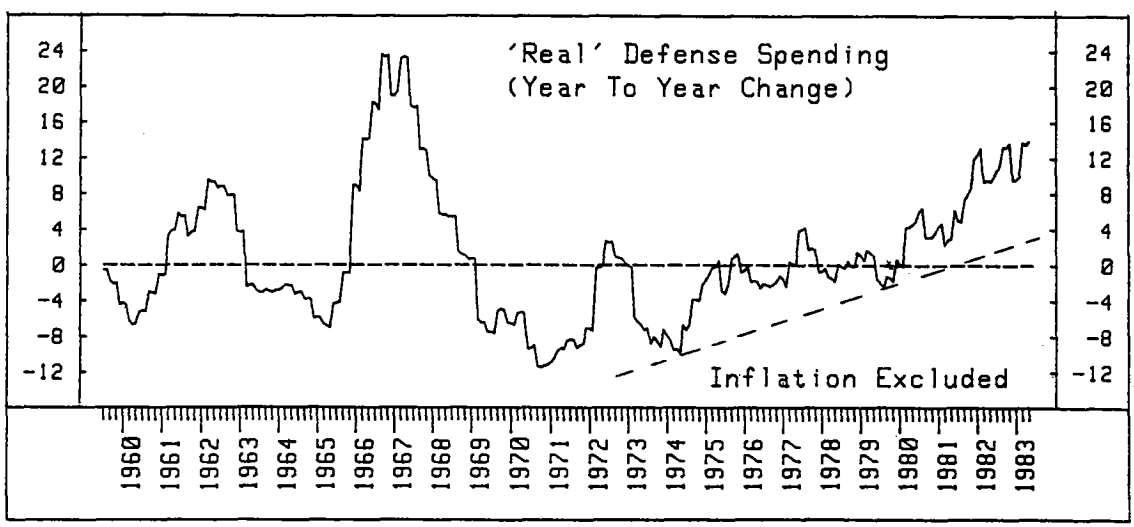
> FORT WORTH (AP) — Texas Instruments Inc. will get an exclusive $7 billion missile contract, despite congressional orders that the deal be split with another manufacturer, the Fort Worth Star-Telegram reported Monday.
>
> In a secret letter to several members of Congress, Deputy Defense Secretary Paul Thayer said TI's HARM missile is needed to protect U.S. warplanes from Soviet air defenses, which could destroy as many as half the U.S. planes sent over hostile territory, the newspaper reported.

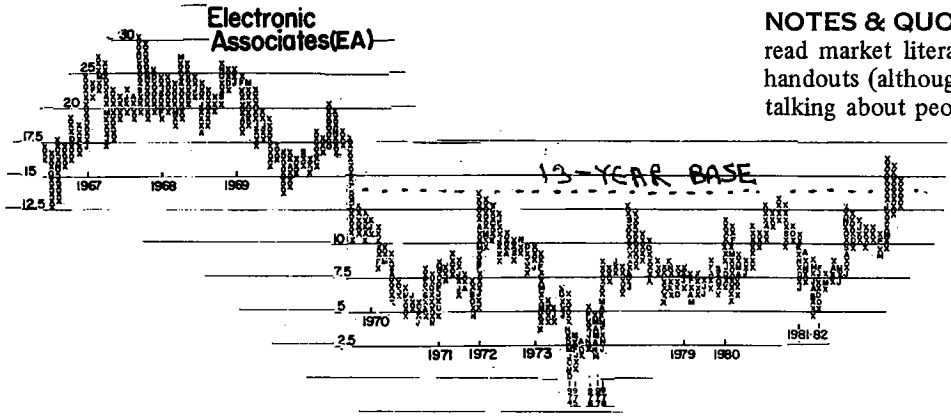
This tell-tale chart (bottom of page) was just published by Ned Davis Research (1-800-241-0621). Ned makes the following comments: *"If you want a group in which the fundamentals cannot miss over the next few years, defense stocks, unfortunately, are the place to be. Our so-called 'window of vulnerability' caused by a sharp negative growth in real defense spending (see chart) from 1969 to 1979 while the Russians 'barreled' ahead has supposedly not really improved much despite a massive catch-up effort since 1981."*

Below is my up-dated list of the defense stocks. Since the last Letter, BBN (Bolt, Beranek, Berman) gave a 50% stock dividend and rose to a new high. For new subscribers, buy equal dollar amounts of these 13 stocks and sit. The defense boom is coming–what you see and read about now is only the beginning!

		Our Buy Price	Current Price	
NYSE	Harris Corp. (HRS)	49½	44 1/2	Defense stock average based on 1 share of each this week is 397
NYSE	LFE (LFE)	11 7/8	18 1/4	
NYSE	Planning Research (PLN)	14 3/8	18 3/8	
NYSE	Scientific Atlantic (SFA)	19	20	
NYSE	Tracor (TRR) (25% stock div)	28 3/4	33 1/4	
NYSE	Electronic Assoc. (EA)	13	14	
NYSE	Varo (VRO)	19	18 3/8	
NYSE	Bolt Beranek (BBN) (50% stock div)	37	85	
NYSE	BDM (BDM) (split 2 for 1)	43½	87	
AMEX	Dynalectron (DYN)	12 3/4	15 5/8	% Increase is: 42.8%
AMEX	Moog B (MOGB)	15½	21 1/8	
AMEX	Systems Planning (SPZ)	7	11 7/8	
AMEX	American Science (ASE)	10½	9 7/8	
	Original purchase price	278		

I have discussed Electronic Associates in a previous Letter. But this chart (courtesy of Market Charts, 20 Exchange Place, NYC 10005) is worth including here. The chart shows a massive 13-year base in EA, followed by the recent breakout above 13. This base is large enough to support an upward move of almost any proportion. I like this stock, I like the action in EA, and I certainly like the technical picture as shown on this long term chart (going back to 1967). As, if and when EA breaks out above 16.5, I would think it would be "off and running." But the breakout from the base has already taken place, and I list it as an attractive long-term holding along with the rest of my defense list. (Chart of EA on p. 4).





NOTES & QUOTES: There is a whole group of investors who read market literature. I'm not talking about reading brokerage handouts (although much broker literature is excellent), but I'm talking about people who pay for market letters and investment material. I don't know how many of these people and institutions exist, but out of the nation's 25 million or so investors, there is probably a pool (this is my guess) of 100,000 people who buy the literature. Many (probably most) of these people read three or four advisories, although they will rotate their reading ("I'm dropping this one for that one, but I'll stay with these two").

Personally, I find most of the new services not worth the time and trouble to read. But new service owners, please don't be insulted, I would say the same regarding at least half of the older services. My main complaint about services that I get nothing out of is–they don't understand markets. But that's just my personal complaint and it's not the final word from above.

Every once in a while a really good, original new advisory comes along. Such a one has just been put out by my old friend, Kiril Sokoloff (author of countless magazine articles, advisory articles and stock market books). The name of Kiril's new service is "Street Smart Investing" and you can get in contact with SSI at PO Box 173, Katonah, NY 10536 (3-month trial is $48).

This service deals with what important stock investors and corporations are doing in the market. For instance, Kiril discloses that investing genius Warren Buffet has taken large positions in General Foods and R. J. Reynolds. Now personally, I am always interested in what Warren Buffet is doing, and you should be too. Buffet's record is amazing. He owns 432,000 shares of Berkshire Hathaway at an average cost of $22 and the stock is now selling around $1000. So what Buffet is doing is always fascinating, and this is the kind of material that Street Smart Investing goes into. Kiril Sokoloff is a fine investigative reporter and writer, and I like this new service very much.

* *

Question: Do the Soviets really want to talk disarmament? Or are all their efforts just a smokescreen, an exercise in public relations. Frankly, I am very skeptical of Soviet intentions. I believe that the Soviets are increasing the military gap, and they are increasing it in their favor. Does a potential winner negotiate? Usually he doesn't. This little clip from the New York Times would seem to back up that statement.

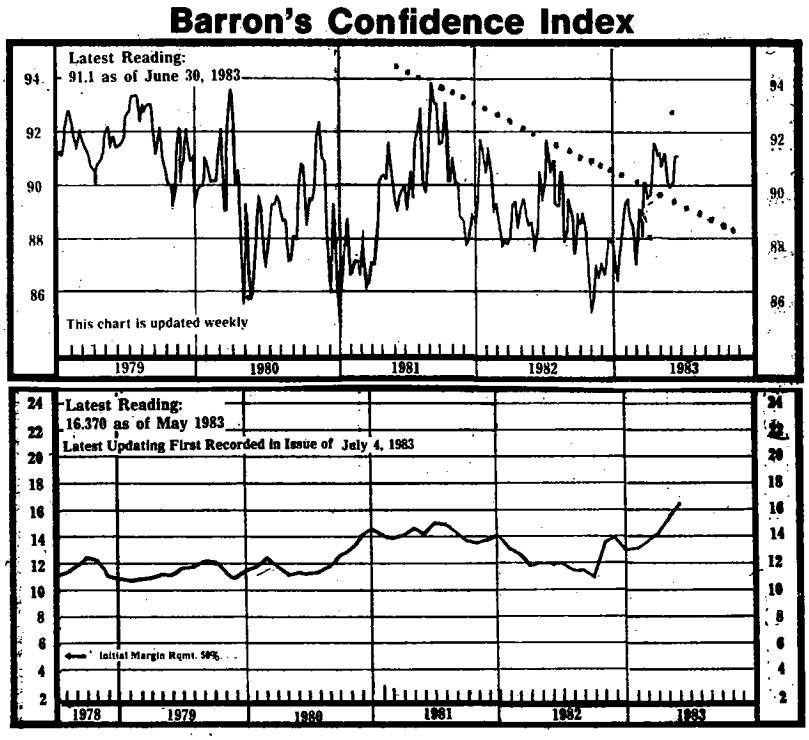
By VICTOR LUSINCHI
Special to The New York Times

GENEVA, July 14— The latest round of talks between the Soviet Union and the United States on reducing intermediate-range nuclear arms in Europe ended here today with no outward sign of progress.

"Not encouraging," was the only comment the Soviet negotiator, Yuli A. Kvitsinsky, would make as he pressed past reporters waiting outside the United States mission and drove off in a limousine.

WHAT THEY'RE THINKING: You hear a lot these days about the deterioration in the sentiment indices. But all is not lost. For instance, two sentiment indices that I watch are doing all right. The first (both charts courtesy of Media General Financial Weekly) shows the Barron's Confidence Index, which is the ratio of gilt-edge bonds to speculative bonds. The theory here is that sophisticated money moves ahead of the markets, and when sophisticated (bond) money feels confident, it is willing to move towards the higher yields of speculative bonds while edging out of lower yielding high-grade bonds. And that is exactly what the Confidence Index is now reflecting. The Index has been in a rising trend since September, 1982, and it is still in that optimistic trend. And that's a plus for the credit markets, the bond markets and the stock market.

The second chart shows the reading on NYSE margin accounts. Margin accounts are at a new high, and this is another bullish sign for the stock market. The reason is that during a bull market (except towards the very end) speculators tend to become increasingly optimistic, and when they do–they use their margin accounts. So as long as margins are rising, the bull is considered to be healthy. It is when the margin account speculators head for the exists that we have to watch out. But that has not yet happened, and it probably won't happen for quite some time.



The talks, which began in November 1981, are to resume Sept. 6 at the Soviet mission.

The latest round of talks opened inauspiciously on May 17, with Mr. Kvitsinsky rejecting in advance a United States offer to amend a proposal for eliminating all intermediate missiles in Europe.

* *

I don't know whether the famous Hunt brothers are still buying or selling) silver. But they are buying something else–San Diego land. Just where the land is or how they are doing it is a bit of a mystery–and this item from the San Diego Transcript (July 15) tells the latest "story" (Bunker, forgive me . . . .)

The Texas Hunt brothers purchased another 10 acres near their planned North County resort. Most property descriptions on grant deeds are confusing enough, but the Hunt transaction beats all. Officially, the two purchased the "south half of the south half of the southwest quarter of the northwest quarter of Section 26..." Find that on your Thomas Bros.

* *

Ah, it's July 22 as I write this (my birthday) and I'm off to New York to my niece's wedding. To leave cool, breezy La Jolla to go to the Big Apple is probably an act of madness, but if 8 million New Yorkers can stand it, I guess I can. By the way, if the temperature is over 90 in the City, I'm officially going to change the name from "The Big Apple" to "The Baked Apple." Have mercy on me New York, get that temperature DOWN!

* *

Mr. Eugene Klein owns the Western AFC Champion football team, the San Diego Chargers. Lately, he has been buying land for his thoroughbred horse operations. In case you're wondering why a smart a fellow like Gene Klein would move at least some of his interest from professional football to horses, ponder this: the price of good football players is going up, up and away, with top rookies now signing million dollar contracts.

Meanwhile, the value of the best thoroughbreds is also climbing. This little clip from the July 20 USA Today tells an interesting story. Just figure what this horse is worth per pound compared with say an all-pro running back!

LEXINGTON, Ky. — An Arab sheik bid a world-record $10.2 million Tuesday night for a colt by Northern Dancer at the Keeneland July Selected Yearling Sale.

The colt, out of the mare My Bupers, was purchased by Aston Upthorpe Stud of England, owned by Sheik Muhammed Al Maktoum, from Du Bai of the United Arab Emirates.

The underbidder, who dropped out at $10 million, was British bookmaker Robert Sangster, who had tied his previous record Monday night by bidding $4.25 million for another Northern Dancer colt.

A LETTER: In Letter 862 (page 5) I presented some thoughts on anger at father and how this retained anger can cost you money in the stock market ("I'll prove I'm smarter than Dad, I'll beat the market and make more money than he ever dreamed of making!").

As I've stated many times, if you have a weakness, if you have unsolved psychological problems, if you are using the market to PROVE something, then my prediction is that you are on the road to losses. This letter came in from Berkeley, California last week, and I thought it worth publishing. Read it and learn. Mistakes and losses are to learn from–your mistakes and the mistakes of others . . .

Dear Richard Russell,

I have been reading your Dow Theory Letters for nearly two years now. I'd like you to know how much I appreciate your humanity and sanity, in contrast to so many other pretentious market writers. I share many of your interests and personality traits (e.g., I too am a voracious reader; I too have been on the path searching for a sane and spiritual way of living in this mad world).

I want to share with you and your readers an unfortunate experience I had so that they can be forewarned. I am involved in an ugly legal battle with a major brokerage firm over enormous losses. As you have so often warned your readers, we were destroyed by selling naked call options into what we believed was a sucker rally. As you have warned correctly, amateurs have no business playing the dangerous options market, especially on the short side.

But I would also like you to warn your readers to be wary of brokers who do not enforce the suitability rules designed to protect under-capitalized investors from selling naked options, and who do not enforce the margin rules designed to minimize losses. These brokers may not even disclose to the potential speculator all the exchange and especially house rules for suitability and margin.

As you can imagine, I have done a lot of soul-searching as to my personality weaknesses that got me into this mess. I did see that my desire to defeat my father was a serious weakness; his approach has always been to buy and hold blue chip stocks, even in bear markets, whereas I tried to make quick profits through market timing. In retrospect, your approach of staying in T-bills in bear markets and buying for the long term in bull markets seems sound.

Another weakness I realized is that the market provides an excitement to someone whose life is otherwise dull–that can be

terribly addictive. Taking risks beyond ones means to satisfy that craving for excitement is not much healthier than shooting heroin. Do you have a remedy for this destructive urge?

Best regards, MJG

GOLD: Congress has never had a love affair with gold. In the wind in Congress now is a change in how gold and other "non-productive assets" are taxed. The House Democratic Study Group is working on a measure that would treat the sale of hard assets including gold as ordinary income (for tax purposes) rather than as capital gains. Part of this plan is a search for new tax income. DSG thinks the change in the way these assets would be taxed could bring in an additional $2 billion for the Treasury. If this bill comes anywhere near materializing, there is going to be pressure on all hard assets including stamps, gold, silver, antique cars, coins, art, etc.

The Aden sisters (old friends of mine) have a wide following among hard asset people. I've differed with them for some time on the future for gold. In their latest (July 7) report, the Adens (at least near-term) are beginning to agree with me. This is from that report: *"Gold continues to be the weakest of the four precious metals and it is the laggard. Chart 1* (I don't show the chart) *shows that gold is also technically weak. In recent months gold has formed a neutral trading range between $400 and $445. Note, however, that a 4½ month downtrend has formed and that gold has been unable to break above it. Gold continues trading near the 5-week average, below the 15 and 45 week moving averages, which is bearish."*

The Adens are still bullish on gold for the long-term, but that's another story. I continue to feel that gold is uninteresting below 445, but that if we get a London fix of 445 or better this would be an INITIAL bullish indication for gold–at which point I would recommend that subscribers do some buying.

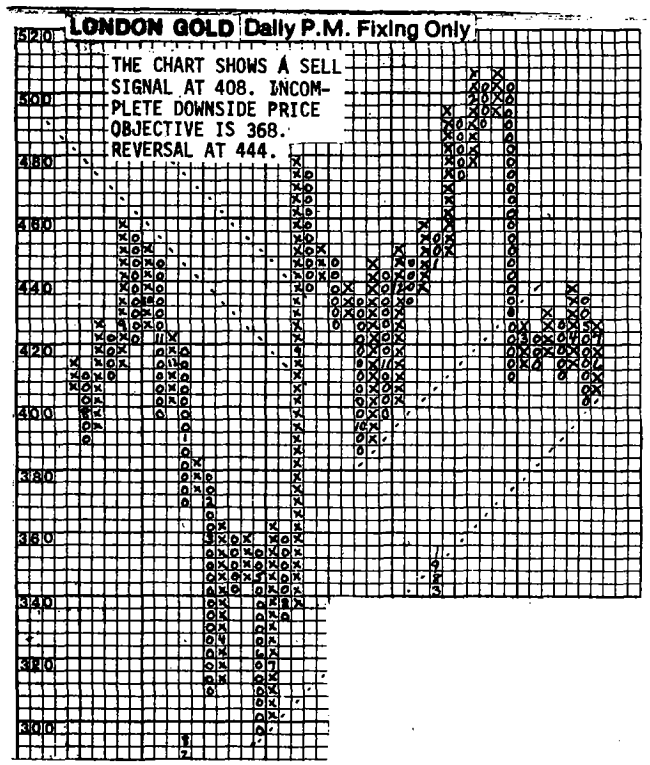
* *

Gold generally moves in relation to REAL interest rates (real rates are the actual rate minus the inflation rate). When gold rises along with interest rates this generally means that gold is moving up in response to the market's expectations of higher inflation (i.e., interest rates will rise if the market expects inflation to rise, since investors during inflationary times, demand higher interest on their money). Thus rising gold and rising interest rates are a sign of forthcoming inflation.

BUT, if gold rises in the face of falling interest rates then we can be suspicious of the gold rise and the inflationary expectations. Why is this? It's because falling interest rates are a function of declining inflation rates, and declining inflation rates are bearish for gold.

Thus, be bullish on gold when it is rising along with interest rates. Be suspicious of gold when it is rising in the face of falling interest rates.

This chart (courtesy of Chartcraft, Larchmont, NY) tells the whole story. Any break below 400 would be ominously bearish for gold. Conversely, a spot price of 444 would constitute a bullish breakout. From the frustration standpoint (and I have sneaking suspicions that is what gold-philes are looking at) gold could just sit in the 400-444 range for many more months. Most hard money people believe the primary trend of gold is up. I rate it neutral–with a 50/50 chance that it is bearish. A drop below 400 would convince me that gold's primary trend is down.



LATE NOTES: As I perceive it, the stock market has been absorbing the upward explosion of July 20, and it has been absorbing it in a highly bullish manner. The Averages evidenced very little give as the week ending July 22 came to a close.

The PTI has held within a few points of its record 1687 high, and any rallying action this week should take the PTI to a new all-time high. The important thing is that the PTI has been holding above its rising trendline, and in time this action will exert upward pressure on the stock market.

I am still intrigued by the latest record short interest figures. I realize that a good chunk of the total NYSE short position is made up of arbitrage, but the fact is that a lot of it is still pure shorting. And that shorting is AGAINST THE PRIMARY TREND OF THE MARKET. The sheer amount of shorts is not the essence of the situation, but it is the fact that so many people are willing to bet on a decline.

In a primary bull market *the odds always favor the upside* and near the end of a great bull market almost everyone aligns himself with the bull. Thus, the record short interest tells me that we are far from the end of this bull market. When the true final phase of the bull market arrives, I expect to see the short interest dropping for months on end–well before the final peak.

NEXT MAILING: August 10